AMOCO PRODUCTION CO.

IBLA 87-101 Decided May 15, 1989

Appeal from a decision of the Director, Minerals Management Service, denying requests for refund of royalties paid under lease OCS-G 2606 and determining that royalties had been underpaid on leases OCS-G 2606 and 2113.

Affirmed.

1. Oil and Gas Leases: Royalties--Outer Continental Shelf Lands Act: Oil and Gas Leases

Where the lessee under an Outer Continental Shelf oil and gas lease commits 10 percent of its gas production from the lease to a buyer and enters into a transportation agreement with that buyer to transport the uncommitted production to other buyers, the value of a "transportation allowance" (a percentage of the natural gas being delivered to the buyer as compensation for transportation service) will be calculated on the basis of a value determination letter pertaining to the sale of 10 percent of the production to the buyer, and not on the basis of warranty contract prices for sale of gas to other buyers.

2. Oil and Gas Leases: Royalties--Outer Continental Shelf Lands Act: Oil and Gas Leases

Value for royalty purposes is determined independently of the price at which the commodity was sold. Under 30 CFR 250.64 (1981), 30 CFR 206.150 (1987), the value of production for royalty purposes may not be less than the fair market value.

APPEARANCES: George J. Domas, Esq., Robert C. Smith, Esq., New Orleans, Louisiana, for appellant; Peter J. Schaumberg, Esq., Charles R. Shockey, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE LYNN

Amoco Production Company (Amoco) has appealed from an August 12, 1986, decision issued by the Director of the Minerals Management Service (MMS) concerning the proper amount of royalty due for natural gas produced from Amoco's leases OCS-G 2606, Eugene Island Block 301, and OCS-G 2113, Eugene Island Block 322, Offshore Louisiana. The MMS decision concerned three different appeals: (1) MMS' August 9, 1985, demand for payment of additional royalties in the amount of $3,926,188.14 ($1,576,312.30 for lease OCS-G 2606 and $2,349,875.84 for lease OCS-G 2113); (2) MMS' September 5, 1985, denial of Amoco's request for refund in the amount of $51,709.49 for royalties allegedly overpaid on lease OCS-G 2606; and (3) MMS' September 5, 1985, denial of Amoco's request for refund in the amount of $46,186.18 for royalties allegedly overpaid on lease OCS-G 2606.

In 1965 Amoco entered into warranty contracts to deliver gas to the Florida Gas Transmission Company (FGT) and the Florida Power & Light Company (FP&L). 1/ In 1980, before these leases were in production, Amoco entered into another contract by which it specifically committed 10 percent of the gas to be produced from leases OCS-G 2606 and 2113 to the Tennessee Gas Pipeline Company (Tennessee). 2/ By letter dated October 31, 1980, Amoco forwarded a copy of the Tennessee lease to the Geological Survey (Survey), which was then in charge of collection of royalty on offshore leases, stating that 10 percent of the gas produced from these leases would be sold to Tennessee and the remaining 90 percent of the production would be reserved to supply gas under the pre-existing 1965 warranty contracts to FGT and FP&L.

By a "royalty payment and procedure letter" (value determination letter) dated March 12, 1982, MMS informed Amoco that:

> In accordance with 30 CFR 250.66, effective with the date of first production [from the two leases], the value for computing royalties shall be based upon the lease delivery volume times the regulated sales price, or higher price if received, including adjustments for BTU content, and the 0.5 cents per MCF gathering allowance as provided in the Natural Gas Policy Act (NGPA) of 1978. All volumes and prices shall be reported and adjusted to a pressure base of 15.025 PSIA.

Between February 1981, the date of first production under these leases, and September 1982, all of Amoco's gas production under the two leases was

1/ As the Board noted in Amoco Production Co., 78 IBLA 93, 99 (1983), "[i]n a 'warranty' contract, the producer agrees to sell a specific amount of gas[,] and the gas delivered in satisfaction of this obligation may come from any source without regard to designated wells or fields. Shell Oil Co. v. Federal Power Commission, 531 F.2d 1324, 1327 n.6 (5th Cir. 1976)." It is not clear from the record how Amoco satisfied this contract before February 1981, but it is not relevant to this appeal.
2/ The record indicates that production under these leases commenced in February 1981.

sold to Tennessee, notwithstanding that it was contractually obliged to sell only 10 percent of production from them to Tennessee. Beginning in September 1982 and continuing through December 1983, Amoco changed its allocation of the gas produced from the two leases, choosing to sell to FGT under its 1965 warranty contract. During this period, Amoco also provided an apparent 3.09 percent of its production from these leases to Tennessee as consideration for the service Tennessee provided in transporting gas to FGT and FP&L (transportation allowance). Later, from June 1 through 9, 1983, Amoco sold gas from the leases to FP&L, again pursuant to its 1965 warranty contract. Significantly, for each of these periods, Amoco paid royalty on both the gas provided to FGT and FP&L and the transportation allowance in accordance with the prices established under the 1965 FGT and FP&L warranty contracts (0.2225 per Mcf and 0.212 per MMBtu, respectively).

By letter dated August 9, 1985, MMS advised Amoco that the prices established under the FGT and FP&L contracts were not acceptable for royalty valuation. MMS stated that the sale prices were significantly less than the value of the gas based on the NGPA classification of the wells. Basing its decision on Amoco Production Co., 85 IBLA 121 (1985), MMS recalculated the amounts of royalty due and informed Amoco that it had underpaid royalties from the two leases in the amounts of $1,576,312.30 for lease OCS-G 2606 and $2,349,875.84 for lease OCS-G 2113, for a total underpayment of $3,926,188.14. MMS directed Amoco to pay these royalty deficiencies.

By letters dated November 14, 1983, and February 23, 1984, Amoco had requested a refund of $46,186.18 for royalties allegedly overpaid under lease OCS-G 2606. This request involved the production months of October 1982 through July 1983. On May 22, 1985, Amoco had requested a refund of an additional $51,709.49, again, for alleged royalty overpayments on lease OCS-G 2606. This request involved the production month of March 1985. By separate letters dated September 5, 1985, MMS denied Amoco's pending refund requests based upon its August 9, 1985, determination of underpayment. Following an appeal by Amoco, both the finding of underpayment and the denial of refund were upheld by the Director, MMS, by letter dated August 12, 1986. Amoco appealed to the Board from this determination.

Two issues are raised in this case: (1) what is the proper royalty valuation of gas provided to Tennessee as a transportation allowance for delivering gas to FGT and FP&L, and (2) what is the proper royalty valuation of gas delivered to FGT and FP&L under the 1965 warranty contracts.

[1] The first issue raised in this appeal was decided by the Board in Amoco Production Co., 96 IBLA 347 (1987), which addressed a similar request for refund arising from recalculation of the transportation allowance provided to Tennessee for transporting gas to FGT and FP&L from lease OCS-G 2113. Without repeating the extensive discussion set out in that case, we note that the Board there held

> that the "transportation allowance" gas delivered to Tennessee to compensate Tennessee for its transportation of gas to Florida Gas and FP&L has the same value for royalty calculation purposes as

> the 10 percent of the gas production sold by Amoco to Tennessee. The March 12, 1982, value determination letter is applicable to the "transportation allowance" gas, either as a direct result of the value determination letter or by way of application of the value determination letter to a value determination made pursuant to 30 CFR 206.150. [3/] The results are the same.

96 IBLA at 351. Accordingly, in the present case, MMS properly valued the transportation allowance for gas transported under lease OSC-G 2606.

[2] The second issue concerns the proper valuation for royalty purposes of gas delivered to FGT and FP&L in 1982, 1983, and 1985 under the 1965 warranty contracts. As MMS notes, the determination in this case must take into consideration prior case law, including Amoco Production Co., 78 IBLA 93 (1983); 4/ and Amoco Production Co., 85 IBLA 121 (1985), on reconsideration, 94 IBLA 129 (1986), appeal filed, Civ. No. 87-0243 (W.D. La. Feb. 4, 1987). Each of these cases in some way concerns the valuation for royalty purposes of gas delivered under the FGT and/or FP&L warranty contracts.

In Amoco, 78 IBLA at 96, the Board held that "[t]he Secretary of the Interior possesses considerable discretion for determining what is the 'value' of production" for royalty purposes, and that this discretion was exercised through promulgation of regulations establishing the factors to be considered in determining value for computing royalties.

The Board further held the gas produced from the lease at issue in 78 IBLA 93, and sold to FP&L pursuant to the warranty contract was not "subject to" an existing contract within the meaning of 15 U.S.C. | 3315

3/ Section 206.150 was formerly designated 30 CFR 250.64. The section was redesignated without substantive change at 48 FR 35641 (Aug. 5, 1983). Both sections provide:

"The value of production shall never be less than the fair market value. The value used in the computation of royalty shall be determined by the Director. In establishing the value, the Director shall consider: (a) The highest price paid for a part or for a majority of like-quality products produced from the field or area; (b) the price received by the lessee; (c) posted prices; (d) regulated prices; and (e) other relevant matters. Under no circumstances shall the value of production be less than the gross proceeds accruing to the lessee from the disposition of the produced substances or less than the value computed on the reasonable unit value established by the Secretary."

4/ Upon judicial review, the Federal District Court for the Western District of Louisiana granted summary judgment for defendants. Amoco Production Co. v. Hodel, 627 F. Supp. 1375 (W.D. La. 1986). This decision was vacated and the case was remanded to the district court with instructions to transfer it to the Claims Court pursuant to 28 U.S.C. | 1631 (1982). 815 F.2d 352 (5th Cir. 1987). Because of the circuit court's vacation of the district court's decision, that decision is without effect and will not be discussed in this opinion.

(1982), 5/ and accordingly, that Amoco's business election to provide gas from the lease under its warranty contract could not "bind the United States to accept a lower royalty than it otherwise would be entitled [to] had Amoco chosen some other source of supply for FP&L." 78 IBLA at 99. The Board concluded:

> Under the circumstances, Amoco's obligation to pay royalties at prevailing "highest price" or "fair market value" is not lessened because it has made long term warranty commitments. The regulations clearly allow the superimposition of a value determination based on actual market conditions on any sales price which falls below the standard of reasonableness. The United States is entitled to its royalty based on "the reasonable value" of the gas as set by the Secretary, which may not be less than the highest price received for similar gas.

78 IBLA at 100. See also Supron Energy Corp., 46 IBLA 181, 187-88 (1980).

A contract for the sale of production from lease OCS-G 1972 to Columbia Gas Transmission Company (Columbia Gas) was considered in Amoco, 85 IBLA 121. Amoco there argued that its contract was misunderstood as committing 100 percent of its share of production to Columbia Gas. Amoco stated it had dedicated only 50 percent of its 50-percent share of production (25 percent of the total production) under lease OCS-G 1972 to Columbia Gas, with the remaining 50 percent of its share (25 percent of the total) to be delivered pursuant to its warranty contract obligations to FGT and FP&L.

The Board found that the value determination letter stated that "[p]ayment on the gas for royalty purposes shall be based on the field delivery volume times the FPC [Federal Power Commission] approved price, or a higher price, if received." Quoted at 85 IBLA 122. The Board held that the royalty value established was "'for Amoco's share of the gas from the above lease,' rather than 50 percent of Amoco's share," 85 IBLA at 127, and that

5/ Section 105, 15 U.S.C. | 3315 (1982), of NGPA, provides in pertinent part:
"Ceiling prices for sales under existing intrastate contracts
"(a) Application. -- The maximum lawful price computed under subsection (b) of this section shall apply to any first sale of natural gas delivered during any month in the case of natural gas, sold under any existing contract or any successor to an existing contract, which was not committed or dedicated to interstate commerce on November 8, 1978.
"(b) Maximum lawful price --
"(1) General rule -- Subject to paragraph (2) and (3), the maximum lawful price under this section shall be the lower of --
"(A) the price under the terms of the existing contract, to which such natural gas was subject on November 9, 1978, as such contract was in effect on such date; or
"(B) the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title (relating to new natural gas)." (Emphasis added.)

the value determination letter and a subsequent amendment evidenced the Survey's intention that the determination was to apply to appellant's entire share of gas produced under the lease, not just that part committed to Columbia Gas. Therefore, when Amoco subsequently decided to use production from that lease to fulfill part of its warranty contract obligations to FGT and FP&L, the royalty value was the amount established in the royalty value determination letter, not the price set in the warranty contracts. The Board concluded

> that the Florida Gas contract price was consistent with the Survey value determination letter, but that this price did not represent the highest price which could be received for similar gas produced under lease OCS-G 1972 pursuant to 30 CFR 250.64 (1982). The "reasonable unit value" was represented by the Columbia Gas contract price. * * * While there is no question that between September 1977 and October 1981 appellant had the right to sell gas produced under lease OCS-G 1972 to Florida Gas, the Department is entitled to collect royalties on the basis of the highest price received for similar gas. In this case, that price is the Columbia Gas contract price.

85 IBLA at 128.

On reconsideration of Amoco, 85 IBLA 121, the Board clarified its holding:

> MMS has regulatory authority to accept a[n] FPC approved contract for royalty basis determination. If the FPC approved contract is designated as being applicable to production from a specific well, whether by the contract terms or by MMS, the FPC contract price will be binding on MMS, unless and until MMS rescinds or amends its acceptance of such valuation basis. * * * However, a value determination letter cannot be construed in a manner which would result in the delegation to a lessee of the discretionary authority to set the value of gas sold.

Amoco, 94 IBLA at 131.

In the present case, the Survey's March 12, 1982, value determination letter was issued pursuant to 30 CFR 250.64 (1981). As noted supra, Amoco's cover letter transmitting the Tennessee contract to the Survey stated that 10 percent of the production from the two leases would be committed to the Tennessee contract, with the remaining 90 percent "reserved * * * to supply gas under its warranty to Florida Gas Transmission Company and Florida Power & Light Company" (Oct. 31, 1980, letter at 1). The value determination letter referred to the Tennessee contract in stating that the royalty would be based on "the regulated sales price" (Mar. 12, 1982, letter at 1), but also stated: "Please mail to this office * * * single copies of any amendments or renegotiations of your present gas contracts within 30 days after the effective date of any such changes." Id. at 2.

Amoco argues that the Survey was aware before issuing the March 12, 1982, value determination letter that only 10 percent of its production from the two leases was being committed to the Tennessee contract, and that it intended to use the remaining 90 percent of the production to fulfill the FGT and FP&L warranty contracts. Although not specifically so stating, it appears Amoco believes this fact distinguishes the present case from Amoco, 85 IBLA 121.

An examination of the Board's prior holdings shows that value for royalty determination purposes and the price at which the product is sold are not necessarily the same. 6/ In the present case, gas was sold under 20-year-old warranty contracts. The FPC-approved price under those contracts clearly did not represent the value of the product being sold from leases OSC-G 2606 and 2113, as is evidenced by the much higher sales price in the Tennessee contract. Despite Amoco's argument concerning the Survey's awareness of the fact that gas produced from these leases might be sold under its warranty contracts to FGT and FP&L, the value determination letter does not designate the warranty contracts as being applicable to production from these specific leases and does not accept the FPC-approved price under those warranty contracts as the royalty value for any of the 90 percent of production not covered by the contract with Tennessee.

Under 43 U.S.C. | 1337(a) (1982) and 30 CFR 250.64 (1981), MMS was required to value the production for royalty purposes at not less than the fair market value. The fair market value for production from leases OCS-G 2606 and 2113 was reasonably set at the price paid under the Tennessee contract, which was a valid indication of the price Amoco could have received on the open market. Supron, 46 IBLA at 187-88. As we have previously held, the fact that Amoco chose to supply its warranty contract obligations from the production under these leases does not lessen the Government's right to receive royalties based on the fair market value of the resource produced. Any other determination would allow Amoco, as the lessee, to set the royalty value of the production sold. 7/

6/ In addition to the Amoco cases discussed, supra, see also Hoover & Bracken Energies, Inc. v. U.S. Department of the Interior, 723 F.2d 1488 (10th Cir. 1983), cert. denied, 469 U.S. 821 (1984) (the Department's authority to establish value of a commodity produced from Federal lands for royalty determination purposes is not limited by statutory or regulatory sales price limitations); Supron, 46 IBLA at 187 (the Department has "considerable latitude in determining what is the 'value' of production from a lease. Amoco Production Co., 29 IBLA 234, 236 (1977). [It] may simply adopt as conclusive the actual amount which a lessee receives from sales of the leased product as its 'value,' or may, in [its] discretion, go so far as to take the highest price paid or offered for the major portion of the gas produced and sold from the field where the leased lands are located as 'value'--a figure which might be substantially higher than the actual sale price").

7/ The Board finds the cases cited by Amoco inapposite.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed. 8/

Kathryn A. Lynn
Administrative Judge
Alternate Member

I concur:

David L. Hughes
Administrative Judge

8/ On May 2, 1989, the Board received a "Second Supplemental Statement of Reasons" form Amoco. This filing has been considered. However, even if the allegations set forth in that document are presumed true, they are not sufficient to prove acquiescence by MMS to accept the 1965 warranty contract prices for royalty valuation purposes. See Supron, 46 IBLA at 189 and n.6.